

A cooperative exempt from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(12), sold its office building under a valid installment sale transaction from which it realized a long-term gain of 100x dollars. Held, in determining whether the organization meets the 85 percent income from members requirement of section 501(c)(12), the amount of the gain that the organization is required to include in its income for the annual accounting period involved, is the income portion of the installment payment actually received during that period.

Advice has been requested whether an installment sale transaction engaged in by an electric cooperative exempt from Federal income tax as an organization described in section 501(c)(12) of the Internal Revenue Code of 1954, would adversely affect the organization's exempt status under circumstances described herein.

The cooperative sold its office building under a valid installment sale transaction for an amount which resulted in a long-term gain of 100x dollars. The organization received a down payment in the year of sale of 30 percent of the selling price and is to receive the balance in two equal installments, one in each of the 2 years following the year of sale. On Form 990, Return of Organization Exempt From Income Tax, filed by the organization for the year in which the sale occurred, the election was made to report the transaction on the installment method.

Section 453 of the Code provides, in part, that income from the sale or other disposition of real property may be returned on the installment method only if in the taxable year of the sale or other disposition there are no payments, or the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price. Under the installment method, a person may return as income in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and as pertinent here provides, in part, as follows:

(12) * * *, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

The 85 percent income requirement of the above statute is applied on the basis of annual accounting periods.

Since the sale of the property in this case is a valid installment sale transaction for purposes of section 453 of the Code, it is concluded that the amount to be taken into consideration for the purpose of the 85 percent member income provision of section 501(c)(12) of the Code is the income portion of each installment payment actually received during a particular year or annual accounting period. Only the amount representing the income portion of the annual installment payments is includible (as income from other than members) in determining whether the organization meets the 85 percent of income requirement for the year or annual accounting period involved.

However, if for any year the income received from the transaction, together with other nonmember income, causes the organization's income from members for the year to fall below 85 percent, the organization is required to file a corporation income tax return, Form 1120, for that year.